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Middle East: Some Implications  
of Increasing Oil Revenues

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MIDDLE EAST: SOME IMPLICATIONS  
OF INCREASING OIL REVENUES

Summary and Conclusions

1. The demand for oil throughout the rest of this decade will be met only by massive increases in output of Middle East oil, which is expected to rise from about 20 million barrels per day (b/d) produced in 1972 to more than 40 million b/d in 1980. Most of this increase will come from Saudi Arabia, Iran, and Abu Dhabi. The resulting revenues, in constant April 1973 dollars, are expected to reach more than \$20 billion in 1975 and between \$30 billion and \$55 billion in 1980.

2. Some important Middle East producers -- Iran, Iraq, Libya, and Algeria -- should be able to spend the bulk of these earnings on military and economic programs. In contrast, Saudi Arabia, Abu Dhabi, and Kuwait, limited by small populations, inadequate numbers of technically capable people, and a dearth of resources other than oil will not be able to increase spending on imports as fast as oil revenues mount. Nor could their gifts to other

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Middle East nations, even on a generous scale, greatly reduce the surplus of receipts over current expenditures. Thus the foreign assets of the Middle East countries could amount to between \$50 billion and \$80 billion by 1980 in constant 1973 dollars. At the upper limit these assets would be equal to about 60% of the world's gold and foreign exchange reserves in 1972.

3. The trends already in motion, if continued through 1985, would result in the Middle East oil-producing states accumulating foreign assets of astronomical proportions. Their assets would range from a low of \$100 billion to as much as \$180 billion by 1985, comparable to total gross US foreign assets and to more than double net US foreign assets in 1971.

4. Foreign assets of such enormous magnitude would be held largely in liquid forms, such as securities and short-term instruments. The Middle East countries lack the industries and managers to make direct investments abroad on a really massive scale. Moreover, an attempt to buy up existing foreign companies could cause strong policy repercussions.

5. In any case, the Middle East oil producers would have unprecedented financial power.

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Discretionary use of such vast assets has enormous potential for disruption of financial markets; attempts to neutralize these assets through capital controls in producing countries might induce the producers to curtail output. If the consuming countries consider the emerging situation as unacceptable, they have little choice but to curb the growth of their consumption of Middle East oil by developing other means of satisfying energy demands and by restraining the sharp rise in their use of energy.

#### Discussion

##### Middle East Oil In Perspective

6. The Persian Gulf and North African members of the Organization of Petroleum Exporting Countries (OPEC),<sup>1</sup> account for nearly one-half of non-Communist production and three-fourths of the oil moving in international trade. Collectively they supply 75% to 80% of Western Europe's oil needs and 90% of Japan's. This dominance is assured for the foreseeable future because these countries have three-fourths of the non-Communist world's proved

1. OPEC members are Abu Dhabi, Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, and Venezuela.

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oil reserves. New production from presently undeveloped fields in Siberia, Alaska, and the North Sea will not diminish the importance of the Middle East during the 1970s.

7. During the late 1960s the bargaining power of the Middle East countries was increased by rising West European and Japanese oil requirements and short-term supply limitations. Taking advantage of this shift, the producing nations negotiated a series of agreements which raised their take per barrel an average of 60% during 1970-72. The first agreement was reached in September 1970, when Libya negotiated a substantial increase in oil tax revenues. Spurred by Libya's success, other countries organized to negotiate tax increases. The oil companies were faced for the first time with a united opposition.

8. In February 1971 the companies conceded tax increases to the Persian Gulf states which were followed by additional increases in Libyan, Saudi Arabian, and Iraqi oil shipped from Mediterranean ports. Meanwhile, Algeria independently nationalized a majority interest in all producing assets in 1971. In early 1972, all area OPEC members received an

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additional increase in revenues of roughly 8% to compensate for the devaluation of the US dollar.<sup>2</sup>

9. In early 1973, Saudi Arabia, Kuwait, Abu Dhabi, and Qatar signed agreements granting them a 25% ownership share in 1973, rising to 30% in 1978 and 51% in 1982. Separate negotiations between the oil companies and representatives of the governments of Iran, Libya, and Iraq will yield further revenue increases for these countries under various formulas. According to the 1971 Geneva Agreement, all Middle East oil-producing countries will receive a 6% increase in revenues per barrel beginning in April 1973 to compensate for the February 1973 US dollar devaluation.

10. Higher tax revenues increased Middle East oil earnings from \$5.8 billion in 1970 to \$9.3 billion in 1971, while output increased only 9%. Earnings in 1972 were \$11.6 billion (see Tables 1 and 2). In several of the larger producing states, oil

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Table 1

Middle East: Oil Revenues

	Billion US \$			
	1969	1970	1971	1972 <sup>1</sup>
<b>Total</b>	<b>5.0</b>	<b>5.8</b>	<b>9.3</b>	<b>11.6</b>
Saudi Arabia	1.0	1.2	2.2	2.9
Iran	0.9	1.1	1.8	2.4
Kuwait	0.8	0.9	1.4	1.7
Abu Dhabi	0.2	0.2	0.4	0.6
Qatar	0.1	0.1	0.2	0.2
Iraq	0.5	0.5	0.8	1.0
Libya	1.1	1.3	1.8	1.6
Algeria <sup>2</sup>	0.4	0.5	0.7	1.2

1. Estimated.

2. Including oil earnings of SONATRACH, the state oil firm that accounts for about 80% of crude oil production.

Table 2

Middle East: Oil Production

	Thousand Barrels per Day			
	1969	1970	1971	1972
<b>Total</b>	<b>15,912</b>	<b>17,546</b>	<b>19,057</b>	<b>20,596</b>
Saudi Arabia	3,219	3,800	4,770	6,015
Iran	3,375	3,829	4,535	5,050
Kuwait	2,801	2,984	3,198	3,287
Abu Dhabi	600	694	934	1,055
Qatar	356	364	430	482
Iraq	1,526	1,566	1,707	1,452
Libya	3,111	3,321	2,762	2,215
Algeria	924	988	721	1,040

earnings now greatly exceed expenditures abroad, and substantial foreign exchange reserves are being accumulated, as follows:

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Country	Foreign Exchange Reserves
	December 1972 (Billion US \$)
<b>Total</b>	<b>10.7</b>
Saudi Arabia	2.5
Iran	0.9
Kuwait	2.7
Abu Dhabi and Qatar <sup>1</sup>	0.6
Iraq	0.7
Libya	2.9
Algeria	0.4

1. March 1972.

### Prospects

11. Middle East oil production is expected to increase rapidly from 20 million b/d in 1972 to at least 40 million b/d in 1980. The largest increases will occur in Saudi Arabia (see Tables 2 and 3).

**Table 3**

#### **Middle East: Projected Oil Production**

	Thousand Barrels per Day	
	1975	1980
<b>Total</b>	<b>29,500</b>	<b>41,700</b>
Saudi Arabia	10,000	15,000
Iran	7,000	9,000
Kuwait	3,000	4,000
Abu Dhabi	2,000	4,000
Qatar	500	700
Iraq	3,000	4,000
Libya	3,000	3,000
Algeria	1,000	2,000



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Individual country forecasts are based mainly on worldwide expectations of international Western oil companies.

12. Other projections suggest that Middle East oil production could reach 48 million b/d in 1980. If output in other major producing areas falls short of oil company expectations or world demand expands more rapidly than expected, the increase would almost certainly come from the Middle East. Saudi Arabia and, to a lesser extent, Abu Dhabi and Iraq would provide almost all of the increase, as they have by far the largest unexploited oil reserves.

13. The oil revenues of the Middle East producing states are certain to rise steeply throughout the decade. Agreements now in force provide for annual increases in taxes and royalties per barrel through 1975, and expanded participation will boost oil receipts further. Existing agreements also provide for revenue adjustments to offset changes in international monetary exchange rates. Moreover, when current tax and royalty agreements expire in 1975, the producing states undoubtedly will negotiate additional increases. Because such events cannot be estimated with any degree of pre-

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cision, a range of oil revenues is projected to 1980 in constant 1973 dollars. The lower end of the range is based on a 25% real increase in revenues per barrel by 1980 compared with revenues of April 1973; the upper end of the range is based on a 100% increase in revenues per barrel during 1973-80. Consequently, Middle East oil production of 40 million b/d in 1980 would yield the producing countries revenues of about \$30 billion to \$55 billion (see Table 4).

Table 4

Middle East: Potential Oil Revenues

	Billion US \$			
	Assumption A <sup>1</sup>		Assumption B <sup>2</sup>	
	1975	1980	1975	1980
Total	21.5	33.5	23.5	53.0
Saudi Arabia	6.0	11.0	7.0	18.0
Iran	5.0	7.0	5.0	11.0
Kuwait	2.0	3.0	3.0	5.0
Abu Dhabi	2.0	4.0	2.0	6.0
Qatar	0.5	0.5	0.5	1.0
Iraq	2.0	3.0	2.0	5.0
Libya	3.0	3.0	3.0	4.0
Algeria <sup>3</sup>	1.0	2.0	1.0	3.0

1. Based on a 25% increase in real per barrel revenues by 1980 compared with revenues of April 1973.

2. Based on a 100% increase in real per barrel revenues during 1973-80.

3. Including earnings of SONATRACH, the state oil firm that accounts for about 80% of crude oil production.

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14. Middle East oil states will expand their capacity to spend foreign exchange for consumption, military expansion, and economic development. Iran and Algeria may even borrow additional funds to support domestic programs. Other oil nations will just about break even. Saudi Arabia, Abu Dhabi, and Kuwait, however, already receive oil revenues in excess of foreign expenditures, and their future revenues are expected to outstrip their ability to spend abroad by greater and greater amounts. Even generous gifts to other nations would not absorb much of their surplus earnings. By 1980, total foreign expenditures of all the oil states are likely to reach no more than \$25 billion to \$35 billion in constant 1973 prices.

15. The potential for foreign asset accumulation in the Middle East is vast. The gap between expenditures and revenues will widen rapidly during the decade as production and prices increase. Thus by 1980, annual additions to foreign assets for all Middle East oil producers could range between \$10 billion and \$20 billion, and this would boost foreign assets -- held largely by Saudi Arabia, Kuwait, and Abu Dhabi -- to perhaps \$50 billion to \$80 billion by 1980 (see Table 5).

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Table 5

Middle East: Potential Foreign Assets

	Billion US \$			
	Assumption A <sup>1</sup>		Assumption B <sup>2</sup>	
	1975	1980	1975	1980
<b>Total</b>	<b>22</b>	<b>52</b>	<b>25</b>	<b>80</b>
Saudi Arabia	8	25	9	40
Iran <sup>3</sup>	1	2	1	3
Kuwait	4	5	4	10
Abu Dhabi and Qatar	4	14	5	20
Iraq <sup>3</sup>	1	2	2	3
Libya	3	3	3	3
Algeria <sup>3</sup>	1	1	1	1

1. Based on a 25% increase in real per barrel revenues by 1980, compared with revenues of April 1973 and oil production as given in Table 3.

2. Based on a 100% increase in real per barrel revenues during 1973-80 and oil production as given in Table 3.

3. Reserves estimated to reflect desirable minimum holdings relative to an expanded level of imports.

16. The options available to the producing states for holding down such massive foreign asset accumulations are highly constrained. They could cut production back to levels where revenues and expenditures were in some reasonable balance, but this would be clearly unacceptable to the consuming countries. They could also embark on a program of massive investment in the industrialized countries. The sums involved are so vast, however, that they might pose serious political problems in the West,

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particularly if the Arabs tried to invest all their new wealth or if investments were concentrated in a few industrialized countries. Accordingly, it seems likely that a marked slowdown in Middle East accumulation of foreign assets is possible only through actions of the major consuming countries, which would have to (a) develop means of satisfying their growing energy demands in some manner other than by importing Middle East oil, and/or (b) somehow curb the growth of their energy requirements.

17. The arithmetic of foreign asset accumulation of the Middle East oil-producing states beyond 1980 results in astronomical sums. Even in the unlikely circumstances that earnings surpluses were to level off after 1980, accumulations of foreign assets would still be at a minimum of \$10 billion annually. This could lead to reserves of \$100 billion by 1985 at the lower end of the range; at the upper end, additions of \$20 billion annually would boost reserves to as much as \$180 billion. It is possible that the oil-producing states could increase spending substantially more than we have estimated here. But, it is difficult to believe that such increased spending would reduce reserves much. If the trends already in motion continue to

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operate, reserves would continue to increase sharply in 1980-85. (For a comparison of the eight major oil-producing countries of the Middle East, see Table 6 and the following sections of the text.)

Table 6

Middle East: Comparisons of Oil-Producing Countries, 1971

	Area (Thousand Square Miles)	Population (Million)	Oil Revenues (Billion US \$)	Oil Revenues Per Capita (US \$)	Imports Per Capita (US \$)
Saudi Arabia	618	5.6	2.2	390	190
Iran	636	30.3	1.8	60	330
Kuwait	6	0.9	1.4	1,560	800
Abu Dhabi	25	0.1	0.4	8,000	N.A.
Qatar	4	0.1	0.2	1,470	N.A.
Iraq	172	10.0	0.8	80	80
Libya	679	2.1	1.8	860	370
Algeria	950	15.2	0.7	50	90

Saudi Arabia: Unmatched Wealth

18. Saudi Arabia's already strong financial position will improve during the 1970s more rapidly than that of any other Middle East state. The Saudi government will be in a position of spending a diminishing share of its current oil earnings. Saudi officials acknowledge that imports for defense and domestic development, together with aid disbursements to other Arab states, will fall far short of absorbing future annual revenue increments.

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In 1972, foreign exchange reserves of more than \$2 billion exceeded one year's foreign exchange expenditures. The level of one and one-half times annual imports, which is considered desirable by the Saudi government, will be reached in 1973. Thereafter, sizable funds will be available for investment abroad or for further accumulations of reserves.

19. Saudi Arabian oil revenues jumped from \$1.2 billion in 1970 to \$2.2 billion in 1971, largely as a result of negotiated increases in receipts per barrel. Annual increments per barrel incorporated into existing agreements between the oil companies and the producing states will boost earnings through 1975, after which Saudi Arabia probably will exact further increases in taxes and royalties per barrel. In addition, the recently signed participation agreement will yield Saudi Arabia greater revenues per barrel from its expanding share of production. By 1980, annual oil revenues in constant 1973 dollars may range from \$10 billion to \$20 billion (see Table 4).

20. In 1971, Saudi Arabia produced one-fourth of the oil from Persian Gulf and North African

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states. By 1975 the Saudi share will have increased to one-third and by 1980 to more than 35%. Production is to be increased an average of 12% annually, rising from 6.0 million b/d in 1972 to 15 million b/d in 1980. (Saudi Arabia's Minister of Petroleum and Mineral Wealth has stated that production might reach 20 million b/d in 1980.) Because there will be little change in day-to-day operations, Saudi Arabia's increased participation in production probably will have negligible impact on the general level of production.

21. The Saudis during the 1970s will not be able to spend all of their greatly increased oil earnings. To do so, Saudi Arabia would have to increase its per capita imports many times to above the level of per capita imports of neighboring Kuwait. But unlike Kuwait, whose population is almost entirely urban, Saudi Arabia has a widely dispersed, largely rural population that produces most of its own food. Moreover, Saudi Arabia's population is far less skilled and educated and the government lacks Kuwait's long experience in developing programs to absorb large oil revenues. The three most likely outlets for Saudi earnings, to

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judge from past practices, are domestic development, purchase of foreign military equipment, and aid to other Arab countries. As another alternative, Saudi Arabia has indicated an interest in investing sizable funds in oil installations abroad.

Economic Development

22. Saudi Arabia's intentions to spend generously on economic development are illustrated by recent increases in the development budget from \$580 million in fiscal year (FY) 1970/71, to \$1.1 billion in FY 1971/72, and to \$1.6 billion for FY 1972/73. However, in FY 1970/71 only \$250 million was actually spent on development, and expenditures in FY 1971/72 probably were not substantially greater. Expenditures tend to be limited by bureaucratic delays and by reluctance to initiate changes that would disrupt traditional life styles. In addition, the lack of suitably trained Saudi workers restricts the rate of implementation of development projects.

23. Development expenditures may be accelerated during the mid-1970s as detailed planning is completed, feasibility studies made, and contracts let. If actual expenditures should reach about a billion

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dollars<sup>3</sup> by 1974 and subsequently were increased by 20% a year, the total disbursed in 1980 for development -- of which the bulk would go for imported goods -- would be only about \$3 billion. Limited by a small urban population, growth in consumer goods imports is projected at 10% annually and would boost non-defense imports to only about \$4.0 billion in 1980.

#### Military Expenditures

24. Military expenditures will continue to take a large portion of future Saudi budget allocations. Saudi officials are fearful of encirclement by hostile regimes and are determined to establish and maintain a capability to nullify such threats. The regime also is anxious to build an adequate defense force to enhance its status as a Persian Gulf power.

25. Defense spending, held down during the austerity programs of the late 1960s, was increased from \$380 million in FY 1970/71 to \$570 million in the FY 1972/73 budget. Further increases in defense budgets are inevitable, given the strong pressures of special-interest groups that include

3. All expenditure figures beyond 1972 are projected in constant, April 1973 dollars.

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the powerful Minister of Defense, the hierarchy's "5% men," and foreign munitions salesmen. Foreign expenditures of \$600 million to \$700 million annually through 1975 would be required to meet so-called "basic military needs," according to a study prepared by the US Department of Defense in 1970.

26. Saudi officials, however, have expressed keen interest in going beyond basic needs. They contemplate expanding their military development program to include a much larger navy, more aircraft, additional tanks, miscellaneous vehicles, and substantial investment in cantonments, airfields, and modern aircraft maintenance facilities. If the Saudis opt for the total package, defense expenditures conceivably could approach \$900 million annually. Even if military expenditures develop a momentum in the late 1970s, they still will represent only a small fraction of Saudi Arabia's income. A lack of technical capacity to maintain and operate the large amounts of equipment involved would not necessarily deter the Saudis from large expenditures on military equipment.

#### Aid to Other States

27. In the past few years, Saudi Arabia has given official aid to other countries valued at

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\$160 million to \$215 million annually (see Table 7).  
Additional unrecorded sums have been disbursed to

Table 7

Saudi Arabia: Aid Expenditures

	Million US \$						
	1966	1967	1968	1969	1970	1971	1972
Khartoum aid to Egypt and Jordan	0	35	140	140	140	140	160
Arms purchases for Jordan	0	0	8	7	7	7	7
Other grant aid and loans	15	80	78	13	18	68	163

other Arab states in support of one cause or another.  
Over the next few years, Saudi Arabia almost certainly will be pressed by Arab countries for substantial additional sums because of its strong financial position. Saudi Arabia already has yielded to Jordanian pleas for one-time lump sum aid payments in addition to annual Khartoum allotments since 1970 and has increased financial assistance for development projects in Yemen, Pakistan, and Algeria.

28. If the present talk of unity between Yemen (San'a) and Yemen (Aden) produces no tangible results, the Saudis may increase aid to Yemen (San'a) and Oman in support of their campaign against a mutual antagonist in Aden. Neighboring Persian Gulf states may also receive more assistance

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as the Saudis compete with the Shah of Iran for influence in the area. Morocco, Tunisia, and Sudan may also approach their wealthy brother state for assistance in implementing development programs. The Saudis, however, are careful with their riches, and foreign aid expenditures probably will reach no more than \$3 billion in 1980. Up to now, Saudi Arabia has shown little interest in participating in Pan-Arab banks or multinational regional development funds.

29. These considerations indicate that in 1980 Saudi import expenditures and foreign aid together would be \$7 billion, still well below projected revenues. Annual surpluses could rise from \$800 million in 1971 to \$4 billion to \$10 billion in 1980, with foreign exchange reserves accumulating to somewhere in the range of \$25 billion to \$40 billion (see Table 5).

#### The Overseas Investment Alternative

30. The Saudi Minister of Petroleum and Mineral Wealth, Zaki Yamani, speaking in September 1972 in Washington, D. C., said that if Saudi Arabia is to expand oil production at or above projected rates, high-yield overseas investment opportunities would have to be located. He suggested that Saudi Arabia

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would not be willing to accumulate large holdings of foreign exchange reserves that yielded a low return and that might be devalued.

31. The Saudis view investment abroad in refineries, in distribution facilities, and in tankers as a natural outgrowth of their direct access to increasing amounts of crude oil through participation. Such investment would provide an outlet for excess funds and would more closely link the interests of the producer to those of the consuming countries. It is not possible to project how much Saudi Arabia might invest in oil facilities abroad. The oil industry probably will be seeking about \$100 billion from international money markets during the 1970s. The United States, Western Europe, and Japan would be the prime areas for such Saudi investment. As experience is gained, the Saudis may diversify their investment to include non-oil holdings.

Iran: Big Spender

32. Iran's rapidly expanding economy is heavily dependent on oil revenues, which account for 85% of export earnings and about 60% of annual government receipts. Oil revenues jumped from \$1.1 billion

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in 1970 to \$1.8 billion in 1971 and to an estimated \$2.7 billion in 1972. Physical output was up nearly 20% in 1971 and about 10% in 1972. Agreements now in force<sup>4</sup> provide for increases in prices through 1975. Production through 1975 is expected to grow more than 11% per year. If production plans are met, oil earnings would rise to \$5 billion in 1975 (see Table 4). These substantial increases will not be enough to cover Iran's ambitious public expenditures. Continued external financing will be necessary during at least the first half of the decade.

33. Iran produced one-fourth of all Middle East oil in 1971-72 and will continue to produce about this same share through the 1970s. After 1975, the rate of expansion of oil production probably will decline as output approaches the maximum optimal level of about 9 million b/d. Nevertheless, oil revenues might reach more than \$10 billion in 1980 (see Table 4). Moreover, Iran by 1980 should be earning an estimated \$2 billion a year from exports other than oil.

34. Iran is vigorously pursuing economic development. National goals as stated in the develop-

4. Including the preliminary agreement initialed in March 1973.

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ment plan include maintenance of economic growth at the rate of 11% through 1978. Iran has a larger, more highly skilled population and a more highly developed industrial sector than neighboring oil states. Most capital equipment and related technical services, however, must still be imported. In 1971, non-defense imports of goods and services totaled \$2.1 billion.

35. Iran has the most powerful military force in the Persian Gulf area and spends heavily on defense imports. Estimated imports of defense and defense-related items -- such as construction materials for military bases and inputs to munitions production -- rose from \$75 million in 1964 to more than \$600 million in 1971. Recently signed contracts with the United States, the United Kingdom, and the USSR point to continued large military imports. By 1980, military imports certainly will be well above the current level.

36. Iran's total foreign expenditures in 1980 probably will absorb most of even the maximum projected levels of foreign exchange earnings and will depend largely on the size of its oil income. During 1973-77, Iran plans to spend more than \$30 billion

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abroad on imports of goods and services, according to estimates by Tehran. Continued expansion of foreign spending through 1980 at rates consistent with current plans would raise foreign expenditures from almost \$3 billion in 1971 to more than \$10 billion in constant prices in 1980.

Kuwait: Rich Conservationist

37. In 1972, Kuwait produced 16% of Middle East oil. Production and revenues are expected to expand less rapidly than those in most Middle East states. Concern over depletion of reserves has prompted Kuwait to limit expansion of oil production to 2% a year. Kuwait shares, of course, in increases in revenue per barrel negotiated under OPEC. Thus, annual oil earnings are projected to increase from \$1.7 billion in 1972 to between \$3 billion and \$5 billion in 1980 (see Table 4).

38. Kuwait's oil receipts make up 95% of export earnings, 84% of government revenues, and 75% of total foreign exchange earnings. Long one of the most prosperous countries in the Middle East, Kuwait has well-developed outlets for its foreign exchange earnings. In 1971, imports, mostly investment and consumer goods, were valued at \$850

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million. In addition, Kuwait dispenses aid to many Arab states through the Kuwaiti Fund for Arab Economic Development, regional development funds, or local financial institutions. Annual aid disbursements since 1970 have amounted to \$190 million, including Khartoum payments of \$120 million to Jordan and Egypt. Kuwait's considerable investments abroad in a variety of assets were increased by almost \$700 million in 1971. Interest payments on these foreign investments bring in \$200 million to \$300 million a year.

39. Kuwait's future expenditures probably will reflect past trends. Continued spending on domestic development, welfare programs, and demands created by an inflated government payroll could expand real non-defense imports about 11% a year -- about as fast as during the late 1960s. At this rate they would exceed \$2 billion in 1980. Although Kuwait will no doubt purchase armaments abroad, imports of military equipment almost certainly would not exceed \$100 million in most years. The small Kuwaiti armed forces of 15,000 men, including 7,000 policemen, is not likely to be greatly expanded. Foreign aid disbursements could be expanded but

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probably will not exceed \$0.5 billion to \$1.0 billion a year by 1980, leaving \$0.2 billion to \$1.5 billion that could be added to foreign exchange reserves or invested abroad.

40. Kuwait is the only Middle East oil state which has been wealthy for many years. Its foreign exchange reserves exceeded \$1 billion as early as 1966 and had grown to more than \$2 billion in 1972. These reserves may double by 1975 and triple by 1980. The government is required to put oil royalties into state reserves to hedge against the eventual depletion of oil reserves, and Kuwait has years of experience in investing abroad. The government recently expressed an interest in investing in oil assets in the United States, Canada, and Japan.

Abu Dhabi and Qatar

41. Abu Dhabi and Qatar together produce 7% of Persian Gulf and North African oil. Oil earnings are large relative to their respective populations of roughly 50,000 and 136,000, and combined foreign exchange holdings surpass \$600 million. By 1980, Abu Dhabi's oil production will exceed current Kuwaiti levels and, combined with much smaller

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Qatar output, will generate revenues from \$4 billion to \$7 billion (see Table 4). Combined imports of Abu Dhabi and Qatar in 1970 are estimated to have been about \$150 million. Neither of these affluent states is inclined to spend heavily on military equipment, but imports may increase rapidly as Abu Dhabi seeks to spend its explosively increasing revenues. The inclination to give aid to other Arab states has risen with recent oil revenue increases. Aid may reach as much as \$0.7 billion to \$1.0 billion annually during the decade. Nevertheless, by 1980 foreign expenditures probably will not exceed \$2 billion, and the reserves held by these tiny states could reach about \$15 billion to \$20 billion. Although they could afford to reduce oil production, Qatar and Abu Dhabi generally follow the lead of Saudi Arabia. They may invest some surplus funds in fixed assets abroad.

Libya: Financial Tightening

42. During recent years, Libya has realized substantial surpluses in its balance of payments and has added to its foreign exchange reserves at unprecedented rates. Libya's reserves of \$2.9 billion in December 1972 were the largest in the

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area. However, prospects are dimming for continued large-scale accumulation of financial reserves. In 1972, Libya trailed Saudi Arabia, Iran, and Kuwait in oil production. The Libyan authorities cut production from 3.7 million b/d in April 1970 to 3.0 million b/d in August 1970 to pressure companies into accepting new tax demands. Subsequently, production problems, marketing difficulties, and state efforts to conserve oil reserves have caused an almost uninterrupted decline in Libyan output. Production in 1972 was about 2.2 million b/d. Increased revenues per barrel boosted oil earnings from \$1.3 billion in 1970 to \$1.8 billion in 1971; earnings will be about \$1.6 billion in 1972.

43. At current levels of output, oil revenues will little more than cover anticipated expenditures. In 1971, Libyan aid disbursements, mainly to Egypt and other Muslim states, totaled \$370 million. Estimated imports of defense equipment reached about \$140 million, and other imports for development and consumption were about \$640 million. By 1975 these combined expenditures could total more than \$1.5 billion.

44. Several factors make Libya's future financial position difficult to project. The proposed union

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with Egypt, if implemented, would increase foreign exchange requirements for the merged state sufficiently to call for increased Libyan oil production and perhaps substantial foreign borrowing.<sup>5</sup> The increase in annual expenditures resulting from the union of Egypt and Libya might absorb an estimated increase in revenues of about \$700 million that could be derived by expanding Libyan oil production to 3 million b/d. Increased annual requirements of the merged state would include Egypt's current account deficit, which in 1975 could exceed \$200 million a year. If Egypt's client-state relationship with the USSR were ended because of the union, an additional \$100 million to \$350 million annually would be required to maintain Egypt's present military machine. Moreover, after union Egypt might not continue to receive Khartoum aid payments of about \$190 million from Saudi Arabia and Kuwait.

45. Libya's policies with respect to the participation agreements that are presently under negotiation could prevent increases in output or could even result in further cuts. Libya appears



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intent upon accelerating ownership transfers at a rate exceeding that negotiated under OPEC for most area states. Having nationalized British Petroleum (BP) operations in Libya in December 1971 and having obtained a 50% share in new production by the Italian state oil firm ENI, Libya has demanded 50% participation in BP's partner company, Bunker Hunt, and in the Oasis group.<sup>6</sup> As of March 1973 these companies have resisted Libyan demands in the interest of protecting the more moderate participation agreements with the Persian Gulf states. In the event of the possible unilateral nationalization of foreign oil companies, Libyan production might suffer from punitive action.

46. These uncertainties in the Libyan case, together with the mercurial behavior of Libya's leader Colonel Mu'ammarr Qadhafi make any forecast of Libyan oil production particularly difficult. Economic demand for increased oil earnings may well be there, but other considerations may dominate policy.

Iraq: Compensation Issues Settled

47. Iraq accounts for about 10% of oil produced in the Persian Gulf area and North Africa. Output

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6. Composed of Amerada, Continental Oil, Marathon Petroleum, and Shell Oil.

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has been held below potential levels for many years by the failure to agree on compensation for assets nationalized in 1961 and in June 1972. Compensation issues were settled in early 1973, however, and production is expected to increase substantially. State participation in remaining company assets is still to be settled. The government has agreed in principle to the accords reached by other Persian Gulf countries, but difficulty in working out details could disrupt production.

48. Oil revenues account for more than three-fourths of government revenues and nine-tenths of export earnings. They finance a large share of the ambitious development program designed to diversify the country's economy. Development spending in Iraq's \$5 billion 1971-74 development plan was cut back in 1972 because of expected revenue losses following nationalization. In FY 1972/73, government investment has been reduced from \$736 million to \$361 million. As production rises, development expenditures probably will be increased. In any event, Iraq's long-term objective of reducing dependence on oil revenues already has been delayed.

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49. Because most Iraqi military assistance comes from the Communist countries, expenditures for defense have been only indirectly affected by oil revenues. The repayment of loans in petroleum has been acceptable to the Communists since mid-1972. Communist economic aid also is being made increasingly available to Iraq in exchange for oil. Further commitments to repayments in oil for aid from Communist countries will also encourage Iraqi efforts to raise oil output levels.

Algeria: Support for Development

50. Algeria's economic needs suggest that oil production will be increased as rapidly as possible; production may even exceed currently projected levels. Algeria's earnings from oil are projected to rise from \$700 million in 1971 to about \$2 billion to \$3 billion in 1980 (see Table 4), reflecting a scheduled increase in output from 721,000 b/d to 2,000,000 b/d.<sup>7</sup> Natural gas sales of about \$40 million in 1971 also are expected to increase sharply to about \$750 million in 1980.

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51. Oil, gas, and other foreign exchange earnings taken together probably will not be large enough to finance Algeria's projected foreign expenditures. A primary national goal is implementation of the country's ambitious capital-intensive development plans. Planned development could boost Algerian imports from \$900 million in 1970 to \$3.0 billion in 1980, forcing Algeria to seek foreign investment and credit in most years.

52. Other factors suggest that Algeria will not choose to restrict oil production. In 1971 the government nationalized the majority interest in all foreign oil companies operating in Algeria. Since then the state firm SONATRACH has produced and marketed about 80% of Algeria's oil. Interested in establishing a reputation as a reliable supplier, Algeria would be reluctant to risk losing current or prospective petroleum markets by restraining production. In addition, the government is trying to attract foreign investment in petroleum exploration in Algeria in order to reduce the heavy dependence on SONATRACH for investment. Any arbitrary reduction in oil output would undermine this policy.

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